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IAS® Standard 24 Related Party Disclosures



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IAS® Standard 24 Related Party Disclosures

An entity can become partners with other entities in its business life. Depending on the nature of this partnership, an entity can control other entities or can influence other entities significantly (IAS 24.5). Entities can engage in commercial activities with their partner. These activities may be carried out to benefit any of the entities within the group. In other words, commercial activities carried out in a partnership may be non-arm's length transactions. For example, when one of the entities within the group sells goods to the other, it may sell at the cost price rather than at the standard selling price, or it may sell with longer terms than the terms it has offered to the entity outside the group (IAS 24.6). The commercial activities carried out in this way affect the financial position and performance of one of the entities positively and the other negatively. Even if related entities do not carry out commercial activities with each other, an entity that has control or significant influence can affect other entities' financial and operational policies. For example, an entity may prevent a subsidiary from engaging in research and development activities (IAS 24.7). Due to the existence of these possibilities, users of financial statements should be informed about the related parties of the enterprises while making their decisions.

OBJECTIVE

The objective of IAS 24- Related Party Disclosures is to ensure that related parties and related party transactions are disclosed in financial statements to provide complete and useful information to financial statement users (IAS 24.1).

This standard explains who the related parties are, what related party transactions are, and which information about related parties and related party transactions should be disclosed in financial statements. IAS 24 applies to consolidated, separate, and individual financial statements. (IAS 24.3)

To understand this standard, it is necessary to understand who the related parties are in the first place. A related party is defined as (IAS 24.8):

- a person (or close family members of that person) or entity related to the reporting entity.

Although it is a bit complicated, the person and entities that fall under the scope of the entity's related party are explained in detail in the standard. However, it is stated that the substance of the relationship should be taken into account when determining the related parties and that the legal form of the relationship should not be contented with (IAS 24.10).

First of all, let's try to explain the persons that are considered as the related party of the entity. According to IAS 24.9, if a person;

- has control or joint control of the reporting entity;
- has significant influence over the reporting entity;
- is a member of the key management personnel of the reporting entity or of a parent of the reporting entity; that person and their close family members are considered as related parties.

At this point, it is useful to explain who are referred to as close family members and key management personnel.

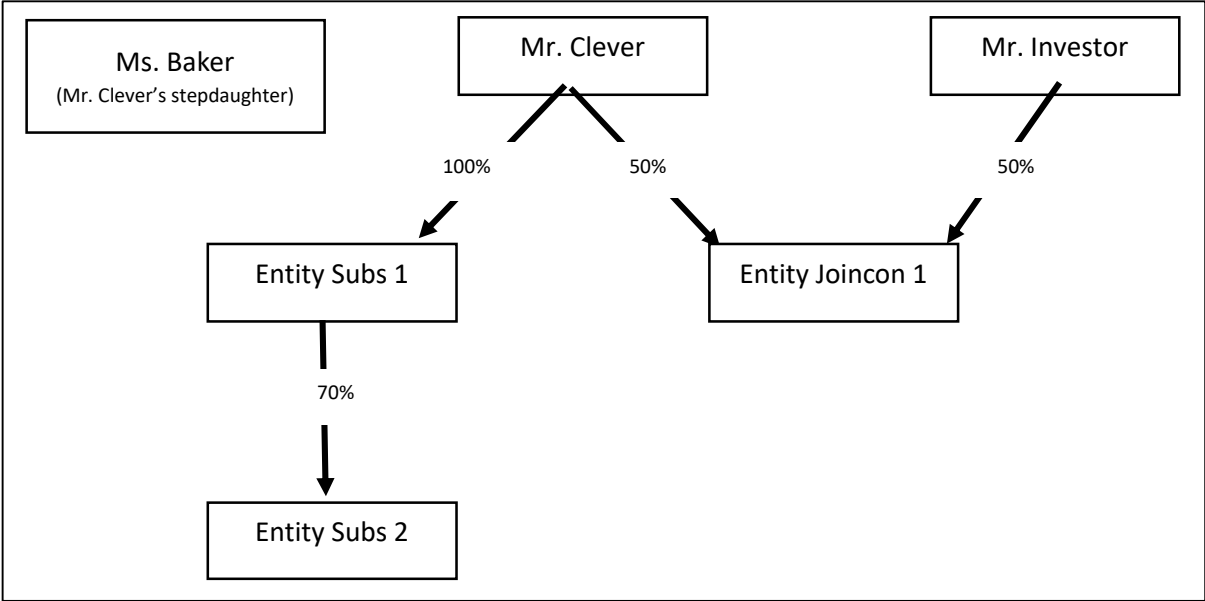
Close members of the family of a person are defined as those family members who might be expected to influence, or be influenced by, that person in their dealings with the entity. Close family members of a person can be listed as follows:

- the person's spouse,
- the person's children,
- children of that person's spouse
- dependants of that person or that person's spouse

The term "key management personnel" refers to the persons who have direct or indirect authority in and responsibility for planning, directing, and controlling the business's operations. These persons can be an executive, a director, or another individual who has authority in and responsibility for planning, directing, and controlling the business's operations.

EXAMPLE 1

Mr. Clever has 100% share of Entity Subs 1. Entity Subs 1 has 70% share of Entity Subs 2. Mr. Clever and Mr. Investor control Entity Joincon1 jointly. Ms. Baker is the daughter of Mr. Clever's spouse. Examine the related party relationship.



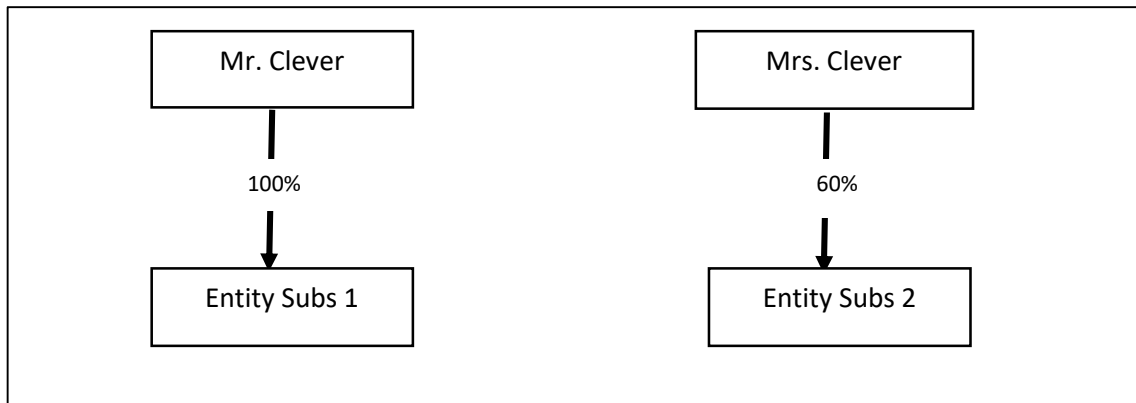
In this case, related parties are as follows:

- Mr. Clever has control over Entity Subs 1. So Mr. Clever is the related party to Entity Subs 1.
- Entity Subs 1 has 70% share of Entity Subs 2 and controls Entity Subs 2. Because Mr. Clever controls Entity Subs 1, he has indirect control over Entity Subs 2. Mr. Clever is the related party to Entity Subs 2. (Entity Subs 1 and Entity Subs 2. are related parties too. The related party relations between the entities will be mentioned in the following section.)
- Ms. Baker, the stepdaughter of Mr. Clever, is a related party both to Entity Subs 1 and to Entity Subs 2. Because she is a close family member of Mr. Clever

- Mr. Clever has a 50% share of Entity Joincon1. Mr. Clever and Mr. Investor jointly control Entity Joincon 1. Mr. Clever and Mr. Investor are related parties to Entity Joincon 1. Their close family members are related parties to Entity Joincon 1, as well.

EXAMPLE 2

Mr. Clever has 100% share of Entity Subs 1. Mrs. Clever, the spouse of Mr. Clever, has 60% share of Entity Subs 2. Examine the related party relationship.

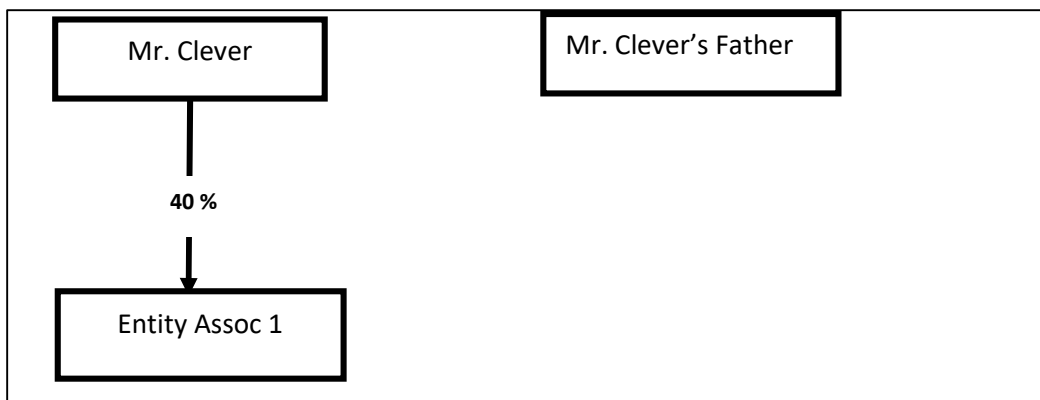


In this case, related parties are as follows:

- Mr. Clever has 100% share of Entity Subs 1. Thus, Mr. Clever controls Entity Subs1. So he is a related party to Entity Subs 1.
- Mrs. Clever, the spouse of Mr. Clever, has 60% of Entity Subs 2; thus, she controls Entity Subs 2. She is a related party to Entity Subs 2.
- Entity Subs 1 and Subs 2 are related parties because a family's close members control them.

EXAMPLE 3

Mr. Clever has 40% share of Entity Assoc 1. Examine the related party relationship.

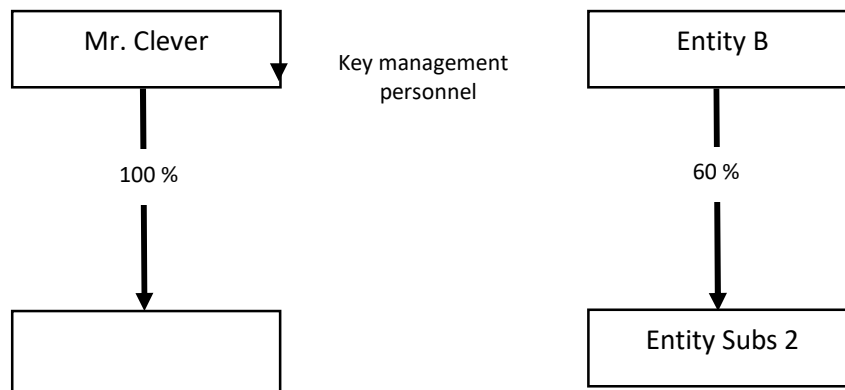


In this case, related parties are as follows:

- Mr. Clever has significant influence over Entity Assoc 1 because he has 40% share of Entity Assoc 1. He is a related party to the Entity Assoc 1.
- Mr. Clever's father is a related party to Entity Assoc 1 because he is a close family member of Mr. Clever.

EXAMPLE 4

Mr. Clever has 100% share of Entity Subs 1. At the same time, he is a key management personnel of Entity B. Entity B has 60 % share of Entity Subs 2. Examine the related party relationship.



In this case, related parties are as follows:

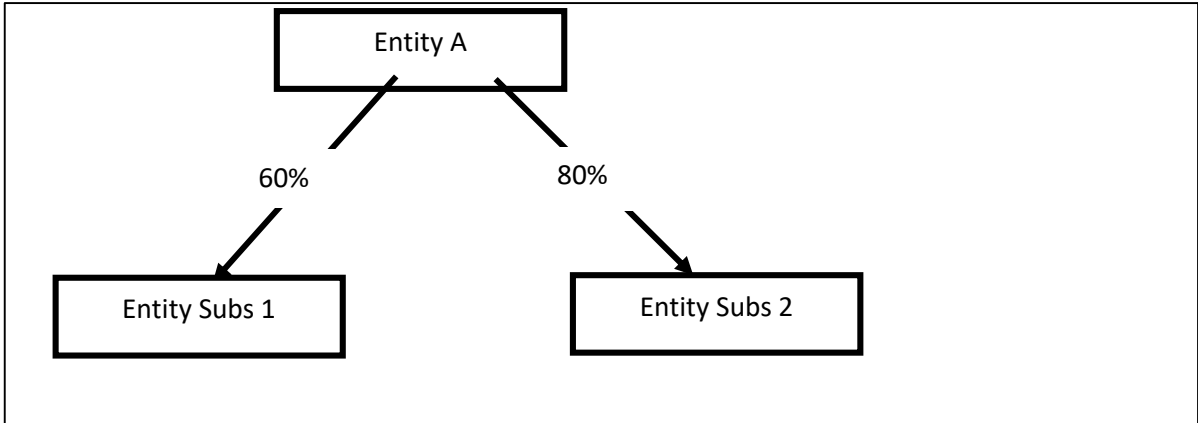
- Mr. Clever has 100 % share of Entity Subs 1; thus, he controls Entity Subs 1. He is the related party of Entity Subs 1.
- Mr. Clever is key management personnel of Entity B. He has responsibility for planning, directing, and controlling the operations of the Entity. Mr. Clever is the related party of Entity B.
- Mr. Clever controls Entity Subs 1 and has responsibility for planning, directing, and controlling the operations of Entity B. So Entity Subs 1 and Entity B are related parties.
- Mr. Clever is a key management personnel of Entity B. Entity B has 60% share of Entity Subs 2; thus, Entity B controls Entity Subs 2. Mr. Clever is a related party to Entity Subs 2 because he is a key manager of Entity B, and Entity B has control over Entity Subs 2.

If we go back to the definition of the related party, it is stated that related parties can be persons or entities. According to IAS 24 (9) following entities are related parties:

- each one of the parent, subsidiary, and fellow subsidiary which are members of the same group
- entities that are associated with or jointly ventured by an entity (or an entity that is a member of the same group). The following are examples that can help to understand this situation:
 - o an investor and its associates (different associates of an investor are not related parties with each other),
 - o an associates' subsidiaries and investor
 - o associates and subsidiaries of an entity
- Joint ventures, subsidiaries of joint ventures, and investors that have joint control,
- An entity's joint venture and associate
- An entity that has post-employment benefit plans regarding reporting entities employees or regarding any entities employees related to the reporting entity
- An entity controlled or jointly controlled by a person who is a related party to an entity
- If a person or his/her close family member who has control or joint control over an entity has significant influence over the reporting entity or is a member of key management personnel of the reporting entity.
- Entity that provides key management personnel services to the reporting entity or another entity that is a member of the same group

EXAMPLE 5

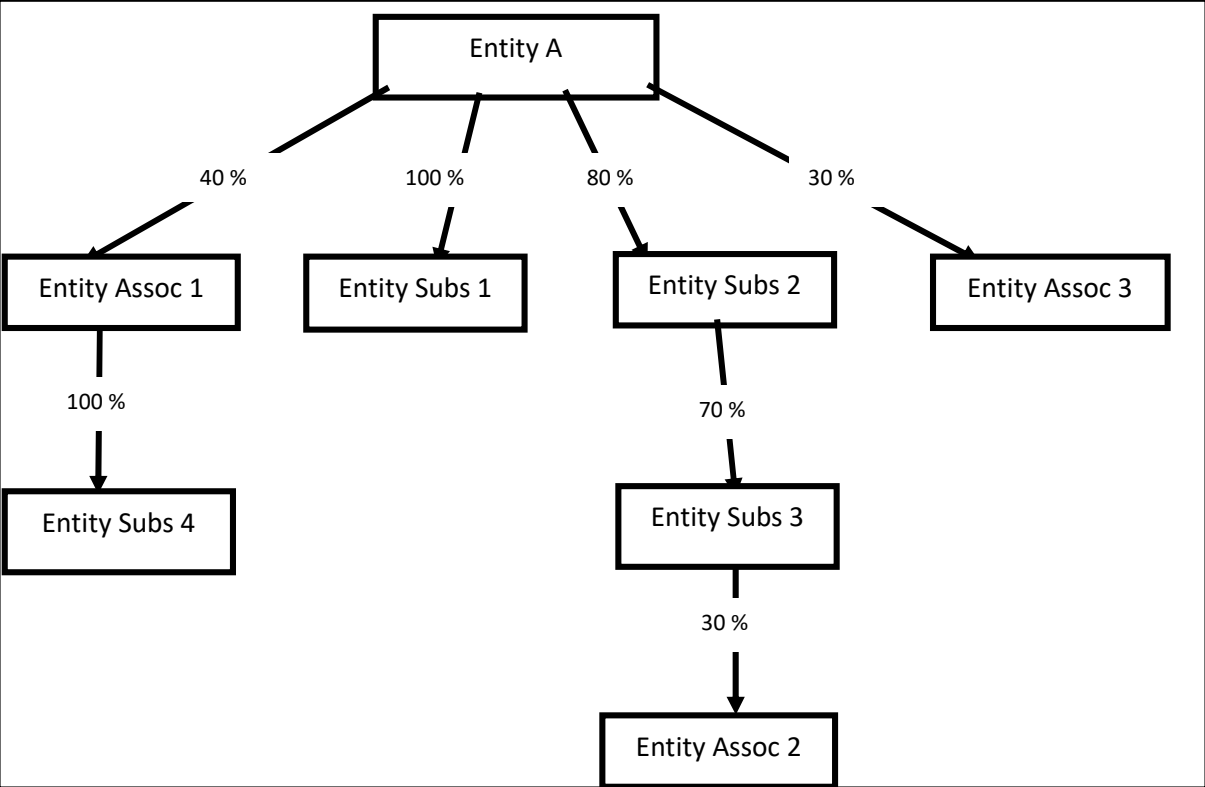
Entity A has 60% of Entity Subs 1 and 80% of Entity Subs 2. Examine the related party relationship.



- Entity Subs 1 and Entity Subs 2 are controlled by Entity A. All of these companies are related to each other. Because they are members of the same group.

EXAMPLE 6

Entity A has two subsidiaries and two associates. Entity A has 100% share of Entity Subs 1, 80% share of Entity Subs 2, 40% share of Entity Assoc 1, and 30% share of Entity Assoc 3. Entity Assoc 1, which is influenced significantly by Entity A, has 100% share of Entity Subs 4. Entity Subs 2, controlled by Entity A, has 70% share of Entity Subs 3. Entity Subs 3 has 30% share of Entity Assoc 2. Thus, Entity Subs 3 has significant influence over Entity Assoc 2. Examine the related party relationship.



- Entity A has 40% share of Entity Assoc 1. Entity A has significant influence over Entity Assoc 1. Entity Assoc 1 and Entity A are related parties to each other.
- Entity A has 40% share and significant influence over Entity Assoc 1 . Entity Assoc 1 has 100% share of Entity Subs 4; thus, Entity Assoc 1 controls Entity Subs 4. Entity Assoc 1 and Entity Subs 4 are related parties. At the same time, Entity A and Entity Subs 4 are related parties. Because Entity A also has significant influence on Entity Subs 4 through its share in Entity Assoc 1.
- Entity A has 30% share of Entity Assoc 3. Entity Assoc 3 is an associate of Entity A. Entity A has significant influence over Entity Assoc 3. Entity Assoc 3 and Entity A are related parties to each other.
- Entity A has control over Entity Subs 1 because it has 100% share of Entity Subs 1. Entity A and Entity Subs 1 are related parties.
- Entity A has control over Entity Subs 2 because it has 80% share of Entity Subs 2. Entity A and Entity Subs 2 are related parties.
- Entity A has control over Entity Subs 2, and Entity Subs 2 controls Entity Subs 3 as it has 70% share of Entity Subs 3. In this case, Entity Subs 2 and Entity Subs 3 are related parties. At the same time, Entity A and Entity Subs 3 are related parties.
- An investor's associates and subsidiaries are related parties. According to this information:
 - o Entity Assoc 1 is a related party to Entity Subs 1, Entity Subs 2, and Entity Subs 3.
 - o Entity Assoc 3 is a related party to Entity Subs 1, Entity Subs 2, and Entity Subs 3.
- Associates of an investor are not related parties. So Entity Assoc 1, Entity Assoc 2, and Entity Assoc 3 are not related parties.

Parties not included in the definition of the related party can be listed as follows (IAS 24.11):

- Entities with the same director or key management personnel
- Neither entity if a key management person of an entity has a significant influence on another entity
- Venturers of the joint venture
- Entities and financiers, unions, public institutions, government departments that have only commercial relations with the entity

DISCLOSURE

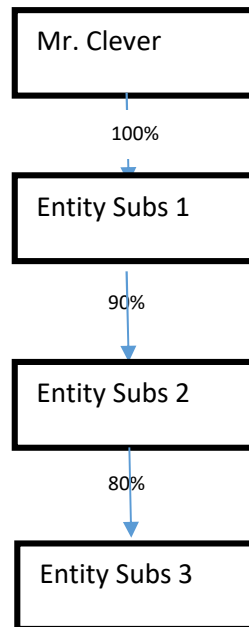
Certain disclosures need to be made in the financial statements so that users of the financial statements can accurately evaluate the entity. These disclosures can be grouped as disclosures on group relationships, disclosures on key management personnel, and disclosures on related party transactions.

Disclosures on group relationships

Relationships between the parent and its subsidiaries should be disclosed even if there are not any transactions taking place between them. The reporting entity should disclose the parent's name. If an ultimate controlling party (different from the parent) exists in the group, the name of the ultimate controlling party must also be disclosed. If neither the entity's parents nor the ultimate controlling party prepares a consolidated financial statement, the name of the most senior parent who prepares the consolidated financial statements must be disclosed (IAS 24.13).

EXAMPLE 7

Mr. Clever has 100% share of Entity Subs 1. Entity Subs 1 has 90% share of Entity Subs 2. Entity Subs 2 has 80% share of Entity Subs 3. Entity Subs 2 does not present consolidated financial statements for public use. Examine the related party disclosures of Entity Subs 3.



Entity Subs 3 discloses in the financial statement the parents (Entity Subs 2), the next most senior parent that prepares consolidated financial statements (Entity Subs 1), and the Ultimate controlling party (Mr. Clever).

Disclosures on key management personnel

Total compensation paid to key management personnel should be disclosed. Total compensation consists of each of the following categories (IAS 24.17):

- short-term employee benefits;
- post-employment benefits;
- other long-term benefits;
- termination benefits; and
- share-based payment.

Disclosures on related party transactions

A related party transaction is a transaction that occurs between related parties for a fee or free of charge. This transaction may relate to the transfer of goods, services, resources, and obligations.

Entities should also provide information about related party transactions in their financial statements. In this context, information to be disclosed can be listed as (IAS 24.18):

- Whether the related party has control, joint control, or significant influence over the reporting entity
- Information about related party transactions and outstanding balances, including commitments. This information should include at least the following:
 - Transaction amounts
 - Amounts of outstanding balances (including commitments), and:
 - the terms and conditions thereof, including whether they are secured and
 - details of any guarantees given or received
 - provisions for doubtful debts regarding related party transactions
 - the expense recognized during the period regarding bad or doubtful debts due from related parties.

Related party transactions should be presented separately according to the nature of the relationship (IAS 24.19). In other words, disclosures should be presented separately for the parent, subsidiaries, associates, key management personnel, etc.

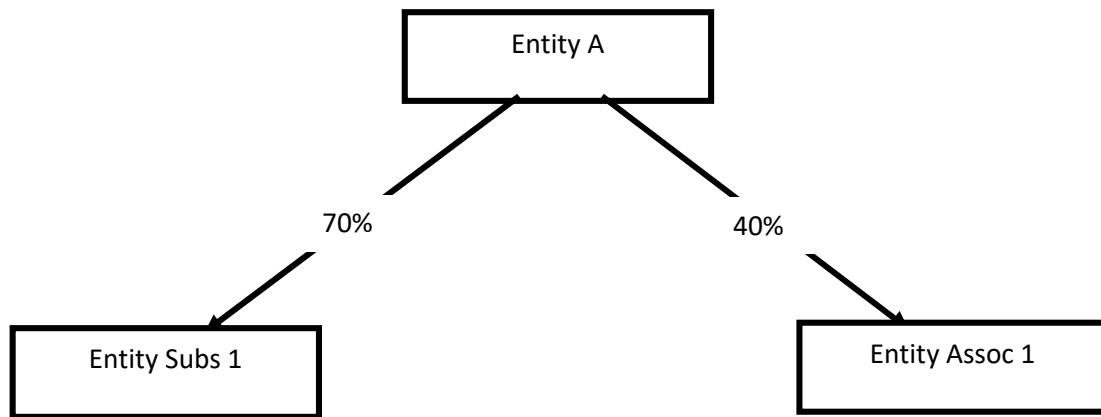
Government-related entities

A government-related entity is an entity that is controlled, jointly controlled, or significantly influenced by a government (IAS 24.9). The term government refers to the government, government agencies, and similar bodies. A reporting entity is exempt from disclosing the above-listed information only if it is a government-related entity. Similarly, transactions between entities that are controlled, jointly controlled, or influenced by the same government are exempt from disclosing the above-listed information (IAS 24.25). These entities should disclose only (IAS 24:26):

- name of the government
- whether the entity is controlled, jointly controlled, or significantly influenced by the government
- the amount and nature of the transaction if it is significant individually,
- A qualitative or quantitative indication regarding the extent of the transactions, if they are significant collectively (not individually),

EXAMPLE 8:

Entity A has 70% shares of Entity Subs 1 and 40% shares of Entity Assoc 1. In the reporting period, Entity Subs 1 sold goods to Entity A for CU200,000. At the year-end, Entity A still owes Entity Subs 1 CU50,000 for the goods. Entity Subs 1 is doubtful to realize CU50,000. In the reporting period, Entity Assoc 1 sold machinery to Entity A for CU300,000. At the year-end, Entity A owes Entity Assoc 1 CU25,000 for the machinery. Examine the related party disclosures of Entity A, Entity Subs 1, and Entity Assoc 1.



SOLUTION

Related party disclosures of Entity A:

In Entity A's financial statements, it should be disclosed that Entity Subs 1 is a subsidiary. In addition to this information, information regarding the transactions between Entity A and Entity Subs 1 (such as the transaction amounts, outstanding balances) should be disclosed as follows:

- The transaction amount: CU200,000
- The outstanding debt balance: CU50,000

In Entity A's financial statements, it should be disclosed that Entity Assoc 1 is an association. In addition to this information, information regarding transactions between Entity A and Entity Assoc 1 (such as the transaction amounts, outstanding balances, and provisions for doubtful debts) should be disclosed as follows:

- The transaction amount: CU300,000
- The outstanding debt balance: CU25,000

Related party disclosures of Entity Subs 1:

Entity A is the parent of Entity Subs 1. Relationships between the parent and its subsidiaries should be disclosed. In the reporting period, Entity Subs 1 sold goods to Entity A for CU200,000. At the year-end, Entity A still owes Entity Subs 1 CU50,000. Entity Subs 1 is doubtful to realize CU50,000. Information regarding the transaction amounts, outstanding balances, and provisions for doubtful debts should be disclosed in the financial statements as follows:

- The transaction amount: CU200,000
- The outstanding credit balance: CU 50,000
- Provision for doubtful debts: CU 50,000

Related party disclosures of Entity Assoc 1:

Entity A has significant influence over Entity Assoc 1, and they are related parties. This relationship should be disclosed in the financial statements. In the reporting period, Entity Assoc 1 sold machinery to Entity A for CU300,000. At the year-end, Entity A owes Entity Assoc 1 CU25,000 for the machinery. Information regarding the transaction amounts and outstanding balances should be disclosed in the financial statements as follows:

- The transaction amount: CU300,000

- The outstanding credit balance: CU25,000